



**King County**

**June 30, 2005**

**Honorable County Executive, Members of the  
Metropolitan King County Council, and King  
County Residents**

We are pleased to transmit to you the Comprehensive Annual Financial Report (CAFR) of King County, Washington, for the fiscal year ended December 31, 2004. This is the third year of implementation for several new reporting standards that have significantly impacted report presentation. The new governmental financial reporting model provides a clear picture of the County as a single, unified entity, while continuing to provide traditional fund-based financial statements. Each perspective (government-wide and major fund) allows the reader to address relevant questions, provides a basis for comparison (year to year or government to government), and enhances the County's accountability.

The report is presented in three sections: Introductory, Financial, and Statistical. The Introductory Section includes this letter of transmittal. The Financial Section, beginning with the independent auditor's report, contains management's discussion and analysis (MD&A), government-wide financial statements, fund financial statements, notes to the financial statements, required supplementary information, combining financial statements, and schedules. The Statistical Section includes selected financial, economic, and demographic data. This letter of transmittal is designed to complement the MD&A, which presents a narrative introduction, overview, and analysis of the financial statements, and should be read in conjunction with it.

The CAFR consists of management's representations concerning the finances of the County. Consequently, management assumes full responsibility for the completeness and reliability of all information presented in this report. To provide a reasonable basis for making these representations, management has established a comprehensive internal control framework designed both to protect the government's assets from loss, theft, or misuse, and to compile sufficient reliable information for the preparation of the County's financial statements in conformity with Generally Accepted Accounting Principles (GAAP). Because the cost of internal controls should not outweigh their benefits, the County's comprehensive framework of internal controls has been designed to provide reasonable rather than absolute assurance that the financial statements will be free from material misstatement. As management, we assert that, to the best of our knowledge and belief, this financial report is complete and reliable in all material respects.

The County's financial statements have been audited by the Washington State Auditor's Office. The goal of the independent audit was to provide reasonable assurance that the financial statements of the County for the fiscal year ended December 31, 2004, are free of material misstatement. The independent audit involved examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements; assessing the accounting principles used and significant estimates made by management; and evaluating the overall financial statement presentation. The auditor concluded, based upon the audit, that there was a reasonable basis for rendering an unqualified opinion that the County's financial statements for the fiscal year ended December 31, 2004, are fairly presented in conformity with GAAP. The auditor's report is presented as the first component of the financial section of this report.

The independent audit of the financial statements of the County was part of a broader, federally mandated "Single Audit" designed to meet the special needs of federal grantor agencies. The standards governing Single Audit engagements require the independent auditor to report not only on the fair presentation of the financial statements, but also on the audited government's internal controls and compliance with legal requirements, with special emphasis on internal controls and legal requirements involving the administration of federal awards. These reports are available in the County's separately issued Single Audit Report.

### **Profile of the County**

The County ranks number one in population in the State of Washington and is the financial, economic, and industrial center of the Pacific Northwest Region. Located between the sparkling blue waters of Puget Sound and the snowcapped Cascade Mountains, the County consists of 2,131 square miles, ranking 11th in geographical size among Washington State's 39 counties. As of December 31, 2004, the County contained 39 incorporated cities, which accounted for approximately 80 percent of its population.

King County operates under a Home Rule Charter adopted by a vote of the citizens of King County in 1968 and is organized under the Executive-Council form of county government. The Metropolitan King County Council is the policy-determining legislative body of the County. The Council's 13 members are elected by district to four-year staggered terms and serve on a full-time basis. The County Council sets tax levies, makes appropriations, and adopts and approves the annual operating and capital budgets for the County. Other elected county officials include the County Executive, Prosecuting Attorney, Sheriff, Assessor, and Superior and District Court Judges. All are partisan positions, elected at large to four-year terms, except for the Sheriff and Judges, which are non-partisan positions.

The County Executive serves as the chief executive officer of the County. The County Executive presents to the County Council annual statements of the County's financial and governmental affairs, the proposed budget, and capital improvement plans. The County Executive signs, or causes to be signed on behalf of the County, all deeds, contracts, and other instruments, and appoints the director of each executive department.

King County provides some services on a countywide basis and other services only to unincorporated areas. Within appropriate jurisdictions, the County provides public transportation, road construction and maintenance, wastewater treatment, flood control,

parks and recreation facilities, court services, law enforcement, agricultural services, inquests, tax assessments and collections, fire inspections, planning, zoning, animal control, criminal detention, rehabilitative services, public healthcare, emergency medical services, election administration, and the processing and disposal of solid waste. In addition, the County has contracts with some cities to provide services to incorporated areas within the County.

The reporting entity "King County" includes four component units: (1) the Harborview Medical Center (HMC); (2) the Washington State Major League Baseball Stadium (WSMLB) Public Facilities District (PFD); (3) the Cultural Development Authority of King County (CDA); and (4) the Flood Control Zone Districts. The Harborview Medical Center, with a history dating back to 1877, is a comprehensive 413-bed healthcare facility operated since 1967 by the University of Washington under a management contract. The general conditions of the management contract specify that King County retains title to all real and personal property acquired with HMC capital or operating funds. The PFD is responsible for overseeing the maintenance and operation of Safeco Field, the Seattle Mariners' baseball stadium. The CDA was created in 2003 to support the arts, heritage, historic preservation, and public art throughout the County. The Flood Control Zone Districts account for the undertaking, operation, or maintenance of flood control projects or storm water control projects that are of special benefit to specific areas of the County.

Most funds in this report pertain to the entity King County Government. Certain Agency Funds pertain to the County's custodianship of assets belonging to independent governments and special districts. Under state statute and the County's Home Rule Charter, the King County Executive is the *ex officio* treasurer of all special purpose districts in King County, but not of cities and towns or the Port of Seattle. As provided by County ordinance, the Director of the Finance and Business Operations Division is responsible for the duties of the comptroller and treasurer. Monies received from or for the special purpose districts are deposited in a central bank account. The Director of the Finance and Business Operations Division disburses monies according to State and local regulations and invests cash balances based on standard agreements with the respective special purpose district's governing body or administrative officer.

### **Factors Affecting Financial Condition**

The information presented in the financial statements is perhaps best understood when it is considered from the broader perspective of the specific environment within which the County operates.

**Local economy.** Economic conditions have a direct impact on the County's revenues and the demand for County services. The County's revenue sources include taxes, charges for services, and intergovernmental revenues. The largest single source is taxes, which comprise approximately one-third of total revenue, and consist primarily of taxes on real property. Property tax revenues tend to be quite stable due to their relationship with assessed valuation. Other tax sources, such as the retail sales tax, are much more volatile and directly influenced by economic conditions in the region.

The 2001 recession had lasting adverse effects on employment and income growth through 2002 in King County. Economic conditions stabilized in 2003 and allowed for employment expansion during 2004, the first such increase in four years. Personal income growth in King County also increased in 2004, accelerating to 4.4 percent in 2004, compared with 2.0 percent growth in 2003. Construction was particularly strong and bolstered the overall County employment market.

For the first time in four years, General Fund retail sales tax revenue in the County increased by 6.16 percent in 2004, a sharp turnaround from the 0.72 percent decline in 2003. Between 2001 and 2003 General Fund sales tax revenues declined by 7 percent; the decline of 3.5 percent in 2001 was the first since the institution of the local option sales tax in 1971. Property value growth remained relatively slow in 2004, with assessed valuation up 5.5 percent, compared with 4.8 percent growth in 2003, 6.6 percent growth in 2002, 12.0 percent growth in 2001 and 13.3 percent growth in 2000. The ailing commercial market has stabilized, but positive valuation growth is almost entirely attributable to robust demand for residential property. Housing has been buoyed in large measure by historically low interest rates. County property tax collections increased by 3.6 percent in 2004, up slightly from the 2.8 percent growth in 2003, but still below the 4.5 percent growth in 2002, 4.6 percent growth in 2001, and 6.6 percent growth in 2000, the year before Initiative 747 took effect (Initiative 747 caps property levies at 1 percent plus new construction).

**Economic outlook.** For 2005, a strong national recovery is expected to fuel steady local improvement. The growth in total regional employment in 2005 is forecast to outpace population growth, 2.7 percent to 0.9 percent, as it did in 2004 by 1.4 percent to 0.5 percent. Stronger personal income growth is also anticipated.

The County will continue to face numerous challenges including volatile energy prices and the need to raise sufficient revenues to pay for the operations of its utilities, transit system, and general government operations. Rising healthcare costs pose problems across the government, mirroring the national experience.

**Long-term financial planning.** After aggressively managing significant General Fund budget shortfalls over the last five years, estimates of the structural imbalance have been revised downward. Despite Initiative 747's tight constraints on property tax revenue, the County has succeeded in holding down cost growth. Instead of previously published estimates of 5-6 percent, current projections place the annual expenditure increase needed to maintain status quo service levels in 2006 at 3.82 percent. No deficit is presently forecast in the General Fund for 2006, 2007, or 2008.

Sharp spending reductions and a steadfast commitment to the County's 6 percent undesignated reserve policy carried the County through the 2001 recession and its aftermath. The County plans to continue this strategy should the deficit return in the future, and the often painful process of reducing expenditures to match revenue levels while retaining prudent reserves.

## **Major Initiatives in 2004**

### **Health Advisory Task Force**

A Health Advisory Task Force (HATF) convened in December 2003 to develop a strategy to address problems facing the healthcare system in the Puget Sound region. In particular, the task force focused on three interrelated issues:

- the increases in healthcare costs for both patients (employees and their families) and purchasers (employers who buy coverage through benefit plans)
- the quality of care provided by health professionals
- the importance of improving the health of the community.

The task force included a number of self-insured employers (employers who manage the insurance risks of their employees internally as opposed to through health insurance plans) and experts in the healthcare arena, including physicians, a nurse practitioner, legal, labor and economic experts, and a pharmacist. In addition to relying on its own expertise, the task force invited outside experts to assist in its deliberations.

King County is facing an urgent need to effectively contain rising employee healthcare costs. National healthcare costs (and the cost to the county for employee benefits) are expected to increase at a rate of 15 percent or more per year for at least five more years. For the County, that will represent an increase in spending from \$124 million per year on employee health benefits in 2003 to \$249 million in 2008. This staggering rate of increase and the underlying factors contributing to this trend are the same issues threatening to overwhelm employers locally, regionally, and nationwide. Much of the cost increase relates to care for chronic conditions (which patients and providers can work together to manage) and catastrophic events (which are unpredictable and therefore not amenable to management). The task force recognized that 10 percent of the total work force have chronic and catastrophic conditions; these individuals accounted for 70 percent of the claims dollars in 2002.

The Task Force determined that clinicians, hospitals, purchasers, employers, health plans, patients and policymakers in the Puget Sound area have a critical role to play in aligning the services and systems necessary to make improvements in quality and contain cost. The Task Force recommended a collaborative process to achieve this that included:

- alignment of quality and cost, and
- formation of a collaborative health partnership to forge a leadership alliance among patients, healthcare professionals, purchasers and plans to design and implement an innovative, high quality, and affordable healthcare system in the Puget Sound Region.

### **Snoqualmie Forest Preservation**

In September 2004 King County entered into one of the nation's largest forest preservation agreements for a land acquisition in a major urban area with the \$22.5 million purchase of development rights to the Snoqualmie Forest from Hancock Timber Resource Group. The purchase guarantees more than 90,000 acres of the Snoqualmie Forest will remain working

forest. It reinforces the urban growth line, protects timber industry jobs, and ensures the area will always remain green to the crest of the Cascade Mountains.

The acquisition is nearly twice the size of the City of Seattle and five times the size of Bellevue and will ensure that the rural character of East King County is always maintained. The property, long known as the Snoqualmie Tree Farm, was owned by Weyerhaeuser until last March. Part of the acreage was included in Frederick Weyerhaeuser's historic 1900 property purchase from the Northern Pacific Railroad. The Snoqualmie Forest will serve as a buffer between the Alpine Lakes Wilderness and the county's eastern suburban cities. Purchase of the development rights fairly compensates the landowner for the development value of the property, while ensuring that the foothills forests remain green and productive, providing ecological and economic benefits to everyone in our region.

The Conservation Futures Tax is being used to pay the debt service on bonds that will be issued to purchase the Snoqualmie Forest development rights. In the past 15 years about \$175 million in Conservation Futures revenues have been spent throughout King County to protect 15,000 acres of land at a cost of approximately \$11,666 per acre. Most of the previous purchases were for ownership of the land. The Snoqualmie Forest development rights transaction protects 90,000 acres for \$22 million, or \$244 per acre. The Conservation Futures Tax is a revenue source authorized by state law (Revised Code of Washington (RCW) 84.34.230) for the purposes of acquiring and conserving open space and resource lands. The tax is collected on all taxable property in the county. The money can only be used for the acquisition of open space and resource lands.

#### Hybrid Buses

In 2004 King County Metro Transit purchased new state-of-the-art hybrid buses for routes using the Downtown Seattle Transit Tunnel – 213 will be deployed by Metro and 22 by Sound Transit. Each of the articulated buses is 60 feet long, 102 inches wide, and weighs 44,000 pounds empty. They accommodate 58 seated passengers and about 76 with a full, standing load. The hybrids have a low-floor entry and air conditioning. They have replaced 236 Breda buses built in 1990-91.

The hybrid bus operates on both Ultra-Low Sulfur Diesel (ULSD) and electricity that is generated within the vehicle and stored in batteries on the roof. It will eliminate the need for overhead wires inside the tunnel, which is important since work begins in 2005 to retrofit the tunnel to carry both buses and light rail. Operators and maintenance technicians have embraced the new technology with great excitement. Customers throughout King County have been enthusiastic about the smooth acceleration and quality of the hybrid's ride, and have been most impressed by the significantly reduced noise levels.

The hybrid purchase demonstrates Metro Transit's willingness to explore every possible alternative for cost-effective, clean-air transportation. Replacement of the old fleet of tunnel buses was expected to save approximately \$3.5 million annually in fuel and maintenance costs. Labor costs and parts consumption have declined as planned, and overall fleet availability (time spent in operation rather than in the repair shop) has exceeded expectations.

However, initial savings in fuel consumption have been less than projected. Actual savings will be reinvested in expanded service as outlined in Metro Transit's six-year transit plan.

### **Cash Management Policies and Practices**

King County managed a \$3.4 billion Investment Pool during 2004 and distributed \$78 million in interest earnings to a combination of county agencies and 97 other special districts and public authorities participating in the Pool. In accordance with RCW 36.48.070, the County's Executive Finance Committee reviews the Pool's investment practices and policies on a regular basis. The Pool seeks to obtain a market rate of return while preserving and protecting capital. The investment pool pursues its objectives by investing in high quality securities, including U.S. Treasuries, U.S. Agency notes and mortgage-backed securities, taxable municipal notes, commercial paper, certificates of deposit, repurchase agreements, and the State of Washington's Local Government Investment Pool.

With the exception of one fund, all County monies are invested in the King County Investment Pool. During 2004, the County's Investment Pool realized an average yield of 2.3 percent, down from 2.9 percent in 2003. Interest earnings of County funds in 2004 were over \$28.5 million, including over \$9.7 million for the General Fund.

### **Risk Management**

As a municipal organization, the County has a wide range of loss exposures. The County uses three internal service funds to account for and finance property/casualty, workers' compensation, and employee medical and dental benefits self-insurance programs. Note 10 to the financial statements discloses the specific programs and claims liability changes during 2004 for each insurance program.

### **Pension Benefits**

Qualifying County employees participate in the Public Employees' Retirement System (PERS), the Law Enforcement Officers' and Fire Fighters' Retirement System (LEOFF), or the Seattle City Employees' Retirement System (SCERS). PERS and LEOFF are statewide local government retirement systems administered by the State of Washington's Department of Retirement Systems under cost-sharing, multiple-employer defined benefit and defined contribution public employee retirement systems. Note 8 to the financial statements presents plan descriptions and information on funding policies.

### **Awards and Acknowledgements**

The Government Finance Officers Association (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the County for its Comprehensive Annual Financial Report (CAFR) for the fiscal year ended December 31, 2003. This was the 23<sup>rd</sup> consecutive year that the County has achieved this prestigious award. To be awarded a Certificate of Achievement, a government must publish an easily readable and efficiently organized CAFR that satisfies both generally accepted accounting principles and applicable legal requirements.

A Certificate of Achievement is valid for a period of one year only. We believe that our current CAFR continues to meet the Certificate of Achievement Program's requirements and we are submitting it to the GFOA to determine its eligibility for another certificate.

The preparation of this report would not have been possible without the efficient and dedicated services of the Financial Accounting staff of the Finance and Business Operations Division. We would like to express our appreciation to all members of the division who assisted and contributed to the preparation of this report. Credit must also be given to the Executive and County Council for their support for maintaining the highest standards of professionalism in the management of the County's finances.

Respectfully submitted,



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Ken Guy  
Interim Finance Director  
Finance and Business Operations Division



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Caroline McShane, CPA  
Interim Chief Accountant/Manager  
Financial Management Section